

**STATEMENT OF
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SBA'S FISCAL YEAR 2005 BUDGET REQUEST**

Madame Chairman, Ranking Member Kerry, and members of the Committee, thank you for inviting me here today to discuss the President's Budget Request for the U.S. Small Business Administration (SBA) for Fiscal Year (FY) 2005.

At the SBA, we have completed one of our most important years ever. The SBA has continued its drive to simplify and improve the Federal government's role in providing capital and technical assistance to America's entrepreneurs. The diversity and success of companies supported by the SBA has been a major factor in the current economic recovery. We're proud of that success. At the same time, though, we must keep a watchful eye on the taxpayers' stake in these programs. As much as we have achieved in the past, we have a change to improve upon our record.

As the President has emphasized, we can ease the unnecessary burdens on U.S. companies – high tax rates, litigation costs, workers' compensation and unemployment insurance, skyrocketing health care costs, tax preparation costs, high energy prices – and by doing so give those companies a better chance to grow and create new jobs. What's more, if we can encourage private risk-taking, then we can give entrepreneurs the boost they need to find partners, networks, customers, and access to capital. Encouraging private risk taking and investment is one the missions of the SBA.

President Bush understands the vital role that America's small businesses play in creating opportunities. He also recognizes that following times of economic downturn, small businesses play a leading role in economic recovery, and that it is small businesses that generate approximately two-thirds of all new private sector jobs. The President's plan for economic growth and job creation, along with his small business agenda, has been successful in creating an environment in which entrepreneurship can flourish. The SBA's FY 2005 budget is good for America's small businesses and good for the American taxpayers.

The SBA's total budget request is \$678.4 million. This budget request provides for a strong, successful SBA that can effectively and efficiently meet the demands of its customers, America's small business entrepreneurs, while minimizing the cost to the American taxpayer. Through improved management and program reforms, the SBA will better serve America's small businesses.

The SBA requests \$12.5 billion in lending authority for its 7(a) loan program – more than a 30% increase in authority over the level in the FY 2004 omnibus bill. The 7(a) subsidy rate for FY2005 is zero, putting our 7(a) loan program in line with our other major financing programs (504 and SBIC). This subsidy rate is a result of improvements in program design and management, in addition to the development of a new econometric model. The congressionally-

mandated two-year fee reduction, designed to help small businesses during the recession, will expire at the end of FY2004 and the fees will return to their previous statutory level. The resumption to the statutory fee level will result in savings of nearly \$100 million to American taxpayers, and also allow for a program that will be able to meet the demand of small businesses without being dependent on appropriations. Madame Chair, I am also recommending legislation that will give the SBA the permanent authority to adjust the 7(a) fees every year to keep the program at a zero subsidy.

This Budget Request will give SBA the authority to provide \$4.5 billion in loans through its 504 Certified Development Company (CDC) program with no cost to the taxpayers. The 504 program, which was established to increase small businesses' access to real estate and other long-term fixed asset financing, continues to have job creation as an important program goal. The SBA has taken steps to increase small businesses' access to 504 loans by increasing competition among CDCs and streamlining processing. And, as requested, SBA developed an econometric model that is being used for the FY2005 budget request to more accurately measure the cost of the program.

During the course of the SBA's Microloan program's 12-year history, the private sector lending community has come to recognize that micro-borrowers are creditworthy and, further, that they represent substantial future growth opportunities. As a result, private sector lenders are now far more willing to lend to very small and to start-up businesses and in doing so are able to offer more competitive interest rates than the agency's microloan intermediaries. An SBA's analysis of the Microloan program discovered that every dollar lent under the program cost the taxpayers ninety-seven cents. At such a high cost, the agency believes that the SBA should not be competing with private sector lenders interested in developing this market, and has not requested funding for this program in FY2005. Further, the Agency believes that its 7(a) program provides an adequate incentive to lenders who feel that risk mitigation is required to make smaller loans.

In addition to the zero subsidy for our finance programs, this fiscally sound budget is consolidating delivery of services to small businesses which will provide better service to small business owners while resulting in savings of \$30 million. The SBA provides a wide variety of technical assistance services to hundreds of thousands of small businesses annually, and it remains dedicated to providing those services in ways that best serve its clients, America's small business owners. Over the years, the agency's portfolio of small, specific, dedicated assistance programs has expanded dramatically. Unfortunately, funding for these programs has been inconsistent. In fact, many of these targeted programs did not receive funding in FY 2003. In addition, each individual, dedicated program requires specific infrastructure and delivery mechanisms, many of which are duplicative and wasteful.

The SBA believes it can provide a full range of technical assistance more effectively by using its core national delivery programs. The agency will work through its primary infrastructure of Women's Business Centers, Veterans Outreach, 7(j) Technical Assistance, SCORE chapters, the Small Business Development Centers and District Offices to meet the needs of all small businesses. These large core programs have proven their effectiveness. They have extensive resources and well-developed infrastructures. They can reach more customers and offer higher

levels of service to targeted constituencies and, by eliminating the duplicative bureaucracy that is inevitably created by a large number of smaller programs, they can do it far more effectively.

This budget request includes \$3 million to continue implementation of SBA's transformation efforts. I have spoken with many of you personally about the importance of transformation to SBA's future success. These efforts are crucial to the Agency's success in assisting small businesses in its second half-century.

The SBA has existed for 50 years, and much has changed. The agency now works principally through lending and other program partners to provide products and services to small businesses. To coincide with that changed business practice, the agency must realign its resources. The needs of the SBA's customers remain paramount, and modernizing and realigning the agency's human capital resources, operations, and organizational structure to match those needs is crucial to the agency's continued relevance. The SBA is consolidating back-office servicing functions, allowing field office staff to work more closely with their clients in the small business community. The agency's field offices are using technology, outreach, marketing, and customer relationship management to better meet small business needs. Through these modernization efforts, more SBA employees will be in more locations providing direct assistance to the small business community at a lower cost.

The SBA is implementing these modernization efforts based on the success of three district office pilot projects in which loan functions – specifically, 504 loan processing and liquidation and loan buyout processing – were moved to specialized, central locations. The pilots produced impressive results. The 504 program reduced processing time to just two days, seven times faster than the national average of two weeks. The liquidation and purchase pilot has been similarly successful – liquidation cases are now taking months instead of years, and purchases are at 23 days. These dramatic improvements directly affect the SBA's partner lenders, and ultimately, the agency's customers, America's small business owners.

The SBA's Offices of Government Contracting and Veterans Business Development have been working closely with the Federal Acquisition Regulatory (FAR) Council on drafting regulations to implement PL 108-183, signed by President Bush on December 16, 2003. In order for the law to be implemented as expeditiously as possible, the new rules will be published as interim final rules, effective upon publication while at that same time allowing for a 60-day public comment period.

This budget request also includes continued funding for the agency's Disaster Loan Program. The SBA works very closely with the Emergency Preparedness and Response Directorate of the Department of Homeland Security to assist those small businesses and individuals directly affected by disasters such as tornadoes, floods and hurricanes. The SBA is a major part of the government's mechanism to get those people back on their feet in times of trouble when they most need assistance.

Madame Chairman, I want to take a moment to recognize the hard work of our Disaster team in assisting the victims of Hurricane Isabel and the wildfires in Southern California. This has been

a devastating year across the country in terms of natural disasters, and the SBA has consistently been there to assist victims in recovery.

When I appeared before you last year, Madame Chairman, to present the SBA's budget, I testified about the accomplishments we had made so far, and outlined the challenges ahead. This year, I am proud to tell you that progress has been made in meeting those challenges.

Building on its success with the 7(a) econometric model, the SBA undertook an enormous effort to rebuild nearly all of our other subsidy models in 2003. As I pledged to you a year ago, we have completed a 504 econometric model, as well as new or modified models for the SBIC, Disaster Assistance, and Secondary Market programs. In addition, we have continued fine tuning the 7(a) model.

I would like to take this moment to recognize the extraordinary efforts of our CFO team which built these models. Building one econometric model in a year is an enormous amount of work, but our team built three and modified two others in less than a year's time. I am proud of their efforts.

These new or modified models will enable the SBA to allocate its resources more effectively, determine program risk more precisely, and increase our ability to target loans and programs to aspiring entrepreneurs who cannot obtain financing without a government guaranty. In short, implementing these models is a huge plus for small business and the taxpayers because we can now more accurately project the true cost of SBA's programs to the taxpayer.

Last year, I testified before you about the progress in establishing a loan monitoring system – and I am pleased to tell you that the system became operational in Fall 2003. LMS is an incredible success story for the SBA and the Federal government. We are utilizing industry best practices to measure the risk in our 7(a) and 504 loan portfolios. We are so proud of what we have achieved and believe it is the first time the Federal government has adopted such an approach for credit risk management purposes.

Last spring, we hired Dun and Bradstreet and Fair Isaac, two industry leaders in the field of risk management, to provide loan and lender monitoring services for the agency. Credit scoring is at the heart of the system delivered to us in September. Our 7(a) and 504 loan portfolios are credit scored quarterly allowing the SBA to quantify and evaluate loan and lender performance trends. The features of the system include an early warning component, risk ranking of all SBA lenders, and lender and portfolio benchmarking and peer comparisons. These tools, combined with our redesigned lender review process, results in a risk-based approach to oversight that provides the Agency with more meaningful information about SBA's lenders and is more streamlined and efficient, allowing us to better deploy our resources in those areas where the SBA has the most exposure while being less intrusive to the lenders.

Let me now address the issues raised by the SBA's recent financial statements. Let me assure you, I take financial management of the agency very seriously, and we are working diligently to address all of these complex issues.

Asset Sales: Soon after my confirmation in late summer 2001, I became concerned about financial management of the agency in general, particularly the asset sales program. In March 2002, I appointed Tom Dumaresq as the Chief Financial Officer and he in turn put a new financial team in place. This team identified discrepancies when reconciling the subsidy budget model with the actual performance of the sales. Losses were appearing on the financial statements while the model used to calculate the cost/benefit value of selling the loans showed a profit on the loans sold. The SBA then assembled a team of experts, including SBA staff, to identify the cause of this discrepancy. The assessment revealed that three separate areas caused the discrepancies. First, accounting entries overstated loan values and did not fully reconcile to subsidy estimates. Second, the agency's credit subsidy model, which assessed costs at a program level, did not always provide reliable loan cost estimates. Third, the model used to provide individual loan values for asset sales significantly underestimated the projected worth of performing assets and did not reconcile to the subsidy model. As a result, the SBA has rebuilt the disaster loan subsidy model and is now using all available loan data to project the cost of our disaster program. The bottom line is that the asset sales program provided a profit for the nonperforming 7(a) and 504 loans, but a loss for performing disaster loans. This has resulted in adjustments to the FY2001 and FY2002 financial statements as well as an upward re-estimate for FY2003.

Small Business Investment Company Program (SBIC): The venture capital industry suffered losses for the past several years, and the SBIC program mirrored that trend. Previously, the SBIC subsidy model did not use actual historical data, but rather used expert opinion based on industry experience of gains and losses. This year, the SBA is utilizing an improved risk model and actual historical data. The SBA has determined that the SBIC Participating Securities program needs approximately \$1.86 billion more than was previously projected for the cost of guarantees made since 1994. This estimate includes \$314 million in interest on the re-estimate (total re-estimate of \$1.86 billion). The SBA is committed to maintaining the zero subsidy rate for this program and minimizing the costs to the taxpayer; therefore leverage fees will need to increase substantially to keep this program operating. The SBA submitted legislation in June 2003 that would make changes to the program, reducing the amount of the increase. The fee included in the FY2005 budget submission anticipates the enactment of this legislation. We look forward to working with you and with the venture capital industry to come up with additional improvements to the program.

Master Reserve Fund (MRF): The MRF was established to ensure that timely payments are made to investors that participate in the Secondary Market Guaranty (SMG) program. The SBA has improved the oversight and accounting practices of the SMG program for 7(a) guaranteed loans. To properly manage any risk associated with this fund, the SBA is budgeting for the government's liability as required by the Federal Credit Reform Act. This resulted in a \$105 million upward mandatory re-estimate cost in the FY2005 budget. Due to administrative reforms being implemented in FY2004, this program will not require discretionary subsidy appropriations to operate in FY2005.

All of us at the SBA are quite proud of the Agency's legacy of achievement. Many businesses with household names today received SBA assistance in their formative stages. Who knows which of tomorrow's industry leaders are today receiving their 7(a) loans, their SBIC

investments, their government contracting opportunities, or their counseling through the SBA's programs and services?

However, we at the SBA cannot rest on our laurels. The Agency must continue to keep up with and ahead of changes in the marketplace.

We at the SBA are committed to doing all we can to make sure those entrepreneurs receive all the assistance the Agency and its employees can provide. But the SBA cannot do this alone. I want to take this opportunity, while we are all together, to enlist you in these efforts so that this record of achievement will continue.

The SBA's FY 2005 request is a good one for America's small businesses and American taxpayers. It offers an opportunity for us to work together with you, our Congressional partners, to ensure that the SBA continues to assist small businesses into its next half-century. We ask for your support for this budget. Thank you for the opportunity to appear here today. I am happy to answer your questions.